

January 18, 1985

Dear Applicant:

We have considered your application for exemption from Federal income tax as an organization described in section 501(c)(3) of the Internal Revenue Code of 1954.

The information submitted discloses that you were formed on [redacted] under a Partnership Agreement between [redacted], [redacted], and [redacted]. All three individuals are trained instructors of the [redacted] method of teaching English. They are associated with the [redacted], [redacted], [redacted], [redacted], but [redacted] is not a subsidiary of, sponsored by, or under the control of the [redacted].

Under the partnership agreement, you will be equal partners in a non-profit organization (Company) to manufacture and market the Teaching Aid game of [redacted]. Each partner will contribute interest free working capital for the purpose of paying for the initial costs of the venture. The contribution is to be paid back equally as the sale of the game progresses and shall be paid back before any contributions are made to [redacted], [redacted], [redacted], [redacted], or to any other person or agency. If any partner desires to withdraw for any reason, she must give the other partners an opportunity to buy her out for the amount of the unpaid portion of the original investment. The partners are not to be liable for any assessments or charges pertaining to this business operation beyond this initial investment or working capital.

You also have a Constitution which states that the only officer of this organization is the treasurer, who will be elected by majority vote. The stated purposes of [redacted] are to manufacture and market the copyrighted teaching-aid card game of [redacted], and be permanently dedicated to charitable purposes only. Upon dissolution, the total remaining assets of the partnership will be distributed to [redacted], [redacted], [redacted], [redacted], to [redacted], [redacted], or to another tax exempt group. (Records at Internal Revenue Service do not show that the aforementioned Literacy organizations have been granted tax-exempt status.)

You will sell the "██████" game to or through ██████
██████ tutors who are teaching English to functionally
illiterates and immigrants. "██████" is also suitable as a family
game. The possibility exists that the teaching aid game may be marketed
through friends, bookstores, and shops if it becomes popular.

You have had the game printed, collated, and packaged for convenient
handling and marketing, and are having it copyrighted. You plan to
provide money for your local ██████ ██████ ██████
as there is a need for books and other teaching materials and training of
tutors. An article in the ██████ newsletter discloses
that you had a volunteer crew from ██████
assemble ██████ decks of the game, part of which was sold at the national
██████ conference at ██████ ██████.

Section 501(c)(3) of the Code provides for the exemption of organizations
which are organized and operated exclusively for religious, charitable,
and educational purposes, no part of the net earnings of which inures to
the benefit of any private shareholder or individual.

Section 1.501(c)(3)-1(b)(1) of the Income Tax Regulations provides that
an organization is organized exclusively for one or more exempt purposes
only if its articles of organization:

- (a) Limit the purposes of such organization to one or more exempt
purposes; and
- (b) Do not expressly empower the organization to engage, otherwise
than as an insubstantial part of its activities, in activities
which in themselves are not in furtherance of one or more exempt
purposes.

Section 1.501(c)(3)-1(a)(1) of the Income tax Regulations states that in
order to be exempt as an organization described in section 501(c)(3), an
organization must be both organized and operated exclusively for one or
more of the purposes specified in that section. If any organization
fails to meet either the organizational or operational test, it is not
exempt. Organizations which are organized for both exempt and nonexempt
purposes fail to satisfy the requirements for exemption.

Section 1.501(c)(3)-1(b)(1)(iii) of the Income Tax Regulations states
that an organization is not organized exclusively for one or more exempt
purposes if its articles expressly empower it to carry on, otherwise than
as an insubstantial part of its activities, activities which are not in
furtherance of one or more exempt purposes even though such organization
is, by the terms of such articles, created for a purpose that is not
broader than the purposes specified in section 501(c)(3). Thus, an
organization that is empowered by its articles "to engage in a

manufacturing business", or "to engage in the operation of a social club" does not meet the organizational test regardless of the fact that its articles may state that such organization is created "for charitable purposes within the meaning of section 501(c)(3) of the Code."

Section 1.501(c)(3)-1(c)(1) of the I.T. Regs. states that an organization will be regarded as "operated exclusively" for one or more exempt purposes only if it engages primarily in activities which accomplish one or more of such exempt purposes specified in 501(c)(3). An organization will not be so regarded if more than an insubstantial part of its activities is not in furtherance of an exempt purpose.

Section 1.501(c)(3)-1(b)(4) of the I.T. Regulations states that an organization is not organized exclusively for one or more exempt purposes unless its assets are dedicated to an exempt purpose.

Your organization does not meet the organizational and operational tests as described in the Regulations because your stated purposes include both exempt and non-exempt purposes. The manufacturing and marketing of a game for profit, even though the game may be educational, is not an exempt purpose that is specified in code section 501(c)(3). Although one of your stated purposes is that your organization will be dedicated to charitable purposes only, your organization is not operated exclusively for exempt purposes since your profits will be distributed to an organization which is not exempt under section 501(c)(3). Furthermore, in event of dissolution, your assets will be distributed to a non-exempt organizations which are not exempt under Code section 501(c)(3).

Section 1.501(c)(3)-1(d)(1) of the I.T. Regulations states that an organization may meet the requirements of section 501(c)(3) although it operates a trade or business as a substantial part of its activities, if the operation of such trade or business is in furtherance of the organization's exempt purpose or purposes and if the organization is not organized or operated for the primary purpose of carrying on an unrelated trade or business for profit. In your case, you were organized for the primary and sole purpose of conducting a trade or business for profit.

Section 502 of the Internal Revenue Code provides that an organization operated for the primary purpose of carrying on a trade or business for profit shall not be exempt under IRC 501 on the grounds that all of its profits are payable to one or more organizations exempt under IRC 501. Such organizations are known as "feeder organizations".

Under a special rule, for purposes of section 502, the term "trade or business" does not include any trade or business in which substantially all the work is performed for the organization without compensation, or any trade or business which is selling merchandise, substantially all of which has been donated.

It appears that thus far, your organization's activities have been accomplished by donated labor. Therefore, you are not technically a "feeder organization". However, even though you are not a feeder organization, it does not necessarily follow that you are exempt under Code section 501(c)(3). You have no significant charitable activity of your own; and, in fact, your non-exempt manufacturing and marketing activities are your primary and only activities. Furthermore, the designated recipient of your profits will be an organization that has not been recognized as exempt under Code section 501(c)(3). Thus, you are not organized and operated exclusively for charitable purposes within the meaning of Code section 501(c)(3).

Accordingly, we have determined that you are not entitled to recognition of exemption from Federal income tax under section 501(c)(3) of the Code. You are required to file income tax returns on Form 1120.

Contributions made to you are not deductible by the donors as charitable contributions as defined in section 170(c) of the Code.

As provided by section 6104(c) of the Internal Revenue Code of 1954 and the applicable regulations, the appropriate State officials are being notified of our determination.

If you are in agreement with this proposed determination, we request that you sign and return the enclosed agreement Form 6016. Please note the instructions for signing on the reverse side of this form.

If you are not in agreement with this proposed determination, we recommend that you request a hearing with our office of Regional Director of Appeals. Your request for a hearing should include a written appeal giving the facts, law, and any other information to support your position as explained in the enclosed Publication 892. You will then be contacted to arrange a date for a hearing. The hearing may be held at the office of Regional Director of Appeals or, if you request, at a mutually convenient District Office. A self-addressed envelope is enclosed.

If we do not hear from you within 30 days from the date of this letter, and you do not protest this proposed determination in a timely manner, it will be considered by the Internal Revenue Service as a failure to exhaust available administrative remedies and will then become our final determination. Section 7428(b)(2) of the Internal Revenue Code provides in part that, "A declaratory judgment or decree under this section shall

[REDACTED]

not be issued in any proceeding unless the Tax Court, the Court of Claims, or the district court of the United States for the District of Columbia determines that the organization involved has exhausted administrative remedies available to it within the Internal Revenue Service."

Sincerely yours,

[REDACTED]
District Director

Enclosures:
Publication 852
Form 5018

cc: [REDACTED]
[REDACTED]
[REDACTED]
[REDACTED]
[REDACTED]
[REDACTED]